

The Theory Behind Prime Bank Scams as Asserted By Scammers

1. Management of the US dollars in circulation.

The US dollar is the basis of the world's liquidity system and many other currencies base their exchange rate on it. In practice, the US acts as the world's central banker. Management of the US dollars in circulation, both in the US and abroad, is the responsibility of the Federal Reserve system, founded in 1913 by an act of the US Congress. The four areas of FED responsibility are (1) conducting the USA's monetary policy, (2) supervising and regulating banking institutions and protecting the credit rights of consumers, (3) maintaining the stability of the financial system and (4) providing certain financial services to the US Government, the public, financial institutions and foreign official institutions. The Federal Reserve's domestic tools to achieve these targets, including the FED's central responsibility of management of money supply and credit, are interest rate policy, open market operations, reserve ratio policy and moral persuasion. These tools are not always as effective as the Federal Reserve would like them to be. Part of the reason for the less than perfect effectiveness is due to the substantial stock of US dollars in foreign jurisdictions. Several of the Federal Reserve's domestic tools cannot be used in other countries, for example, the Federal Reserve cannot change foreign reserve ratios. Furthermore, a significant amount of credit creation occurs in US dollars in foreign countries, particularly in the Eurodollar market. As the world's central banker, the US has the key responsibility to maintain stability in the world's monetary system.

Internationally, the currency of choice is often the US dollar as it is considered the safest currency, especially in times of political crisis. Consequently, those holding the dollar do so for reasons which are less sensitive to economic stimuli. Because foreign banks readily accept US dollar deposits, those funds, which in the domestic context are the basis of M1 money supply, act in a foreign context more like the near money features of M3. This means they are infinitely more difficult to control. The offshore market has grown substantially in the last two decades for a number of reasons. First, huge quantities of US dollars associated with the drug trade slosh around the international monetary system, and second, wealthy individuals concerned about high taxes and preserving their wealth opt to keep their assets in offshore tax havens. This significant stock of US dollars cannot be effectively controlled by the US with

its normal domestic policy tools. Finally, currency futures markets can be another difficult area to control because of the substantial amount of leverage that is available. For example, for as little as \$10,000 dollars, it is possible to short or go long \$1,000,000 US dollars versus D-Mark. All other major currencies have a similar leverage viz-à-viz the dollar. This means that even speculators with limited means can take the other side in a Federal Reserve move to stabilize the currency. Since the currency does not have to be delivered as the contracts are rolled near the expiry date, it is possible to create substantial pressure on the dollar in either direction (the Hunts learned this the hard way when they tried to corner the world silver market). The Federal Reserve uses different financial instruments to control and utilize the amount of US dollars in circulation internationally and works with well known international money center banks to issue the related paper.

2. The institutional nature of the system.

A number of problems must be overcome to make the structure work. Inevitably, the offshore US dollars find their way into the international banking system by way of deposits. Therefore, banks must be the main buyers of any financial instruments that the Federal Reserve causes to be issued. However, the rules of the Bank for International Settlements (BIS), the Central Banker's bank in Basle, Switzerland, prohibit banks from buying the newly issued debt instruments from each other directly. This prohibition exists for obvious reasons. If banks were allowed to fund each other, the probability of system-wide bank failure would be increased. This system of funding is not intended to support weak banks; in fact, the opposite objective is the goal. Therefore, a methodology has been constructed that allows banks to buy each other's newly issued paper. BIS rules do not prohibit banks from owning other banks' financial obligations as long as they are not purchased from another bank directly, but instead are purchased in the secondary market.

The Federal Reserve supports a group of intermediaries that have substantial available cash reserves. These intermediaries purchase paper from issuing banks and almost always immediately resell it to other buyers. These intermediaries are called commitment holders or providers. The Federal Reserve licenses its commitment holders to participate in quiet international monetary policy. These commitment holders are identified by confidential, Federal Reserve issued registration numbers. The commitment holders are few in number and it has been reported that there are only 12

commitment holders in the world. They are however essential to the smooth functioning of the process of bringing the debentures to the market. Commitment holders often forge relationships with other sources of funds. These relationships are called sub-commitments. Holding a commitment entails a number of conditions which are extremely important to maintain. First, the commitment holder must be able to quickly produce large sums of US dollars, generally in the billions. This explains why commitment holders are prepared to take on sub-licensees to ensure a large supply of readily available funds. Second, there is a demand for utter secrecy. And finally, this is a "funds first" business. No one can buy issued paper on credit. To ensure that this happens without wasting anybody's time, a commitment holder will not initiate a discussion with anyone unless they can prove cash funds or good quality security.

The Federal Reserve has identified a tier of high quality banks, usually the top 100, which it authorizes to deal in the paper. Criteria for being on the Federal Reserve's list includes strength in the basic banking ratios, sound management, long term stability as well as being in a country in which the Federal Reserve desires to be active. It is evident that the largest supply of international US dollars resides in Europe, which explains the dominance of European banks on the Federal Reserve's list. Another aspect of this fund raising process is the fact that it is conducted entirely off the balance sheets of the issuing banks. The instruments issued are guarantees and as such, represent contingent liabilities. As contingent liabilities, they are not recorded on the balance sheet. However, they do require a risk-adjusted amount of capital reserve as prescribed by BIS rules. By keeping the funding instruments off balance sheets, there is little, if any, disruption of normal financing activities of the banks.

3. Issuing paper.

The Federal Reserve decides which banks will issue paper, what kind and how much at what point in time. A commitment holder and a bank work together to operate a trading program. The commitment holder is the source of funds and establishes a list of banks from which he will accept instruments. The list reflects the preferences of the owners of the funds. Obviously, the strongest banks will appear most frequently on the commitment holders lists. This causes them to benefit the most from this activity. The strongest banks attract most commitment holders to operate trading programs within their establishments.

Banks do the actual trading. They inquire through the Federal Reserve to determine what instruments are available. They are also informed about the banks that wish to acquire paper. They arrange the trades, verify and confirm the securities and clear the trades. The commitment holder is an integral part of the process although it does not have to be present to make it function. The commitment holder simply must leave the required amount of funds at the trading bank in a custody account until the procedures have been properly executed. The commitment holder provides the funds that are used to purchase the initial issue of paper, immediately resold to another bank. There is no room in the system for anyone without funds. This is a principal to principal (bank to bank) business only. The trading bank executes the trades and finds buyers for the issued paper. Outsiders can access the system only by finding a commitment holder and lodging funds with him or with one of his sub-commitment holders. The commitment holder spends most of its time finding investors.

4. Why the yields are so high.

As the investment does not appear intrinsically risky, how are the extraordinary returns of High-Yield programs obtained? There are several factors contributing to this phenomenon.

The international market for US funds is extremely competitive. For example, there are several countries whose desire for US dollars is so high that they will pay annual yields of 20% to 25%, make monthly interest payments in US dollars and issue debentures whose terms do not exceed one year. These are countries whose risk profile is high even though there is no record of default on their obligations. These borrowers set the benchmark at the high end of the yield spectrum. At the other end of the spectrum are very low risk sovereign issuers which are able to attract funds at rates competitive with US treasuries.

Earlier it was explained how the institutional side of this process functions. It was pointed out that when an SLC is issued by a foreign bank on behalf of the Federal Reserve, the foreign bank has to establish a capital reserve. Recent changes to BIS rules require off balance sheet entries to be included in the computation of bank capital adequacy ratios. Furthermore, these assets and all other bank assets must be weighted to reflect their overall risk. Capital adequacy ratios are now all risk adjusted. SLC's fall into the 100% credit conversion factor rating to convert the off balance sheet item

to an on balance sheet equivalent. If banking guidelines require the ratio of total risk weighted assets not to fall below 8%, the bank would have to reserve capital of 8 cents for every dollar of SLC exposure. If a SLC of \$100 million is issued, \$8 million of capital must be set aside. In reality, the capital requirements are not so onerous because there are a number of other factors at work that lower the marginal cost of capital utilization. The issuing bank will also load in a charge for providing the service which could be up to 2%. As we shall see, the banks are paid their fee at maturity or redemption. Next, there need to be a yield spread which will motivate large sums of capital to sit in a custody account in US dollars. The spread earned by the owners of capital and the commitment holder could equal another 4%. This 4% spread would reflect the costs of fund raising and the economic rent of the capital.

The next question is: why would the Federal Reserve be interested in paying these yields? First, it is not as expensive as it might appear. As noted, when the SLC matures, the capital reserve is released. More importantly, the value of the process to the Federal Reserve should be clearly understood. Any country which is attempting to stabilize its currency implements one or both of the following policies. The first line of attack is to manipulate interest rates to increase or decrease the flow of its currency by altering final demand. If speculation becomes too powerful, which it often does, the next line of attack is to intervene in the currency market to remove excess supply or demand. Changing interest rates can be disruptive enough but once the speculators smell a weakening or strengthening currency, it becomes very expensive to rapidly correct the situation. The US dollar is the base currency of global commerce. US dollar speculation could develop at a rate that would be mind boggling. The cost to the global economy would be significant, let alone the cost to the Federal Reserve of intervention. From this perspective, the manner in which the Federal Reserve conducts its activities probably is not expensive. There are countless examples where a central bank has announced it will defend its currency and \$15 billion later it gives up as Britain did when it pulled out of the ERM in 1993. That \$15 billion goes straight into the pockets of the speculators.

The only perhaps negative aspect of this system is that the Federal Reserve is reliant on a group of fund raisers called commitment holders who grew very rich from the service they provide. But this is the only way the Federal Reserve can keep the process

confidential and highly selective. There is an analog in the public markets. NYSE market makers or specialists are a very select club which is extremely difficult to join. Market makers are charged with the responsibility of making a market in their particular stock by managing the balance between supply and demand. Market makers bear risk but it is a risk that most of the time is easily managed. Market making firms have the highest return on capital of any firms involved in the market. Commitment holders are market makers as well, though of a slightly different sort. They do not bear much risk in making a market. Their risk lies in their ability to gather huge amounts of US dollars because, unlike equity market makers, they cannot leverage their capital. The final question is, why does the Federal Reserve not issue securities directly to these banks to attract their dollar holdings? First, the Federal Reserve is not empowered to issue securities; only the US Treasury Department and other agencies guaranteed by the US government can do that. Secondly, selling bonds would be negatively perceived since they are generally used for deficit financing. This process works as well as it does because it is not visible to persons that are not insiders. The issuance of an SLC has the effect that it bids up the price of the dollar as dollars are removed from the huge pool of Eurodollars. And if the Federal Reserve is interested in injecting liquidity into an economy, it simply repurchases outstanding SLC's in the countries where it desires to lower the exchange value of the dollar. We could call it a closed market operation. The domestic analog of this foreign monetary policy is an open market operation.

5. Entry into a trading program.

High-Yield programs are a most difficult area for investors. There are many people around who know certain elements of the marketplace, but very, very few know the entire process. Because enough people know something and the fact that there is significant money to be made, the market attracts many bad players. From time to time these pretenders attempt to pull off a major fraud with a significant investor. This prompts warnings issued by the Federal Reserve, the Comptroller of the Currency, the SEC or the ICC. These pretenders almost always attempt to setup their fund raising efforts in the US. The Federal Reserve, of course, will not have any part of this since the process is designed to control and utilize expatriate dollars, not domestic dollars. Banks routinely deny the existence of these programs, even the ones operating them, as they do not want to discuss publicly private investment opportunities or damage their CD business

(disintermediation). The only way into the system is to be able to certify substantial assets to a commitment holder or one of its sub-licensees. Finding either is no trivial task because there are many more pretenders than legitimate commitment holders. If an investor cannot certify at least \$10 million, in the form of cash or liquid collateral, the chances of getting attention from anyone genuine are remote.

The Response

A number of similar articles have been posted here and on other boards over the years. These articles seek to explain high yield investment programs. Sometimes they are used by the unscrupulous to provide an appearance of legitimacy to their scams, while others may simply represent an attempt to put together the pieces of a puzzle. The author of this article has some knowledge banking and finance, but I regret to say he or she has not thought the problems of HYIP through to their conclusions.

A number of claims are made in the article for the origin or purpose of high yield trading. Most importantly, and in the beginning, the author suggests that high yield trading is a means for the Federal Reserve to control the money supply. Specifically, the author suggests that the Federal Reserve uses high yield trading as a means of controlling the supply of Eurodollars (i.e., dollars located outside the United States).

This is an old myth that has been circulating for years. It is not true. There are a number of reasons why this could not be true – economic, legal and political. Economically, the process described by the author would actually increase the supply of Eurodollars, not decrease it. Encouraging European banks to issue a large number of dollar-denominated instruments in the manner described by the author will do nothing to reduce the supply of Eurodollars. It will increase it.

Legally, the author simply glides over the fact that the Federal Reserve cannot order European banks to issue notes at its behest. It has no legal authority to tell Credit Suisse or Barclays Bank to issue notes. Consider the political ramifications of the

author's hypothesis. The author thinks that European countries would -- for years on end -- allow the US Federal Reserve to use their largest banks to serve US economic interests. Europe is not a monolith, however, and although some countries are quite friendly to the US others are not. Some countries in Europe have consistently opposed US foreign and economic policy -- steel tariffs, banana imports, English language films, agricultural protectionism, and a whole host of WTO trade disputes. There is no way these countries could all fall into line consistently for years on end in the manner supposed.

Interesting, during the past ten years the Fed has gone through periods of seeking to slow the economy by raising interest rates, and stimulating the economy by cutting rates and pumping new dollars into the system. In both periods, high yield promoters have claimed that HYIP is a tool of the Fed to control the money supply in Europe.

The author describes a secret network of commitment holders and sub-commitment holders that supposedly carries out this Fed policy. In this regard, the report is hardly original and falls apart badly. I find it hard to believe that the author could believe what he or she has written.

The notion that the wholesale trading of billions of dollars worth of bank instruments could be kept secret for decades is so implausible as to defy credulity. First of all, they don't show up on the books of the issuing banks. The author falls back on the hoary excuse of "off balance sheet" but surely understands that these items would indeed have to be reported on the books of the company, both for regulatory and public accounting purposes.

The notes also don't show up on the books of the supposed end buyers -- pension funds, banks, and other institutions. Pension funds do have to report their holdings publicly. Look at the books of a pension fund and you will find MTNs, but not the kind proposed by the author. Banks also have to report their securities holdings, yet the high yield instruments don't appear there, either. Where are all the notes?

Lastly, the idea that after so many years the network of secret commitment holders, sub-commitment holders, traders, bankers and investors has never been exposed is simply impossible. In that time, someone would have stepped forward to blow the

whistle. We live in an age when there are very few secrets. We know the women our ex-president slept with, Pentagon and other government secrets, and a host of information we probably would be better off not knowing. A secret network this large and important could not be kept secret for so long. Remember not everyone in that network is getting rich.

The history of prime bank instrument fraud is now largely known. PBI fraud began to appear in the late 1980s, arising from a form of advance fee fraud and commodity fraud. At first, scammers sold the hope of "prime bank instruments." Later, they added the myth of "programs." Variations of historical bonds, Wells Fargo boxes, and 1934 notes developed. Programs for "small investors" (such as Omega) and internet solicitations (Tri-West) became popular. This is the true history, not the misleading panorama painted by the author.

Unfortunately, there are no "programs" or "secret market" for bank instrument trading. It simply does not exist. The author has failed to present a coherent description of an actual system or even a hypothetical system that could operate in the manner described. It is a false and misleading portrait.

The Origin of Prime Bank Fraud

Prime bank fraud can trace its origins to several roots. There is a long history in business of advance fee fraud concerning loans. With varying degrees of sophistication, promoters have for years promised access to low interest rate loans in exchange for the payment of an up-front fee. Closely related to this type of fraud is the self-liquidating loan. Former OCC staffer John Shockey states that he can remember self-liquidating loan proposals from as far back as 1959.

A second source lies in the area of commodity fraud. In the mid-to-late 1980s, one of the first popular computer bulletin boards for business was established by the World Trade Center in New York. This was a dial-up service. It listed offers to sell and offers to buy. Most of the items listed were commodities – scrap metal, jet fuel, Levi jeans, Marlboro cigarettes, sugar, urea, crude oil, and such. Many were "gray market" items that may have been sold outside established distribution channels. Undoubtedly, many were counterfeit. Some people at the time had the notion that they would simply compare the

two lists and match buyers with sellers. It didn't work that easily: the sellers could rarely, if ever, perform, and the buyers were not much better. The business was attractive because the volumes offered were so staggeringly high that a person only needed to close one deal in order to be financially secure for life. In this environment, offers for the sale of currencies and an item unashamedly called "prime bank notes" or "collateral" grew exponentially.

The offers for the sale of collateral at that time listed a number of different types: Prime Bank Notes ("PBNs") were the most important. These came in four flavors. There were 7.5% x 10 year notes, 7.5% x 20 year notes, 14% x 10 year notes, and 14% x 20 year notes. The 14% notes were sometimes dubbed "Japanese notes" because they were supposedly issued only by the major Japanese banks to fund Third World development. At the time, Japanese banks were king of the hill in international banking, by far larger than their Western European and American counterparts. In addition to PBNs, the parties also offered one year, zero coupon Standby Letters of Credit ("SLCs"). Occasionally, one would see an offer for Bank of China notes "wrapped" by Barclays Bank.

The prices offered for these instruments were normally in the 80-85% range for SLCs and in the low to mid 70% range for 7.5% x 10 year PBNs. By today's standards, as well as the standards of the time, this was dirt cheap. Amazingly cheap. Unbelievably cheap. Even then, a distinction was made between offers for the sale of "collateral first" notes versus "funds first" notes. Always, the price of collateral first was higher.

In those days, it was very hard to find reliable information about the market for bank instruments. There was no internet, and communication was normally by fax. The personal fax machine, usually with a roll of uncut thermal paper, was just beginning to become popular. Few people knew very much, and they usually considered what they knew to be a trade secret. I met a large number of people trying to make this business work, and by and large they appeared to be decent, honorable people. Years later, however, I was surprised to learn just how many had criminal records of some kind or other, and how many would later end up being arrested for their activity in this business.

In the late 80s and early 90s, it was not unusual to learn that someone had been in a bank when a transaction went bust and was questioned by the Swiss police for a few hours and then released. In

recent years, the consequences have become much more severe.

During Operation Desert Shield/Storm in 1990, the offers for PBNs slowed down while every night people received countless offers for the purchase and sale of Kuwaiti Dinars. As with the gray market goods, the quantities offered were fantastic, in the trillions of dollars. Thousands of offers for this relatively unknown currency were made. It is unclear whether any of these transactions ever closed. Phone service at this time was much more expensive than it is now, and many who participated in this market wound up spending more each month for their telephone than for their monthly housing expense. Russian rubles became an item of great interest at this time, as did hallmarked gold sold at unusual discounts.

During this time, a new instrument appeared on the scene that soon dominated the market: the Prime Bank Guarantee ("PBG"). The PBG was similar to the PBN in terms of interest rate and maturity, but was priced (usually) one point higher. If PBNs were offered for 73% of face, then PBGs would be offered for 74%. It was explained that this was because they had a higher priority among creditors in the event of bankruptcy. Soon, even though other instruments were still offered, PBGs supplanted the others and became the big kid on the block.

Many people didn't care where these instruments originated, or why they were issued, but for those who did ask such questions in the early 1990s, the answers given were that the notes were issued at a "cutting house" (separate and apart from the bank) pursuant to a "master collateral commitment." Could you look in the phone book under "C" for "cutting house"? Not exactly. Where were such cutting houses located? Few explanations were given, although many pretended to have "inside knowledge" and were sworn to secrecy.

What about the Master Collateral Commitments? Sometimes draft copies were circulated, but they were usually poorly drafted with numerous typing mistakes, re-faxed with important information whited-out, or obvious forgeries. Often people would try to explain that there were seven, or five, or three, or eleven or some other number of Grand Masters – the appointed few who controlled the world of collateral, and from whom all such notes were issued. Various theories were floated about how such a small number of people could secretly control such an important area of finance. There was no agreement.

I traveled extensively throughout Europe at this time, and can

remember well one banker at a private bank in Geneva turning to me and asking, "Why would a top bank issue their instruments so cheaply?" He explained that he had seen numerous offers for the sale of these instruments, but had never seen one close. I didn't have an answer for him. We traveled to Zurich the next day to pick up the note we had confirmed the day before, but by the time we arrived it had somehow disappeared.

Zurich was a major hub of such activity, and I made many trips there. The hotels were full of people on the same quixotic quest. In the early 90s, I learned of a new opportunity. This was called the "roll program." In this scenario, instead of arranging a buy and sell of bank instruments, a "program manager" did all the work for you and all you needed to do was come up with the money. No expertise in banking or the selling of securities was needed. This idea soon caught fire and the number of offers for the sale of instruments declined dramatically as "programs" rose to prominence.

A number of programs were offered with different configurations at the time. Initially, an investor simply transferred the money to the "program manager" and that was it. No security was asked for or given. Even then, however, investors were wary, because so many offers to sell had turned out to be bogus. As a result, program promoters began to offer a 108% bank guarantee to secure the investor's funds. (One could legitimately wonder what money was available for trading if the investor's funds were used to purchase a bank guarantee.) This set up was eventually replaced by a 106% bank guarantee, a 104% bank guarantee, and all sorts of similar arrangements. Sometimes the program managers offered a "subaccount" or a "parallel account" or a "blocked funds letter" structure to assure investors their money would not be stolen. Despite their appearance of safety, many investors lost money through these schemes.

This was also the era of the "one day program." In this scenario, the investor would walk into a bank in Zurich in the morning with a check for several million dollars, and return in the afternoon of the same day to pick up the un-cashed check and another bank check for many multiples of his original check. There was no investment, just profit. There were many variations on this theme, including "table top" closings. Thousands of people flew to Switzerland to pursue this dream.

Still, PBNs and roll programs were mired in controversy. Many

investors lost their money, arrests were made, and some banks even became involved in the mess. For example, a bank in eastern Europe called Banka Bohemia issued hundreds of millions of false instruments at the behest of some crooked bank officers. The Salvation Army in London lost money in a highly publicized scandal. Many brokers became tired of chasing after uncooperative investors and chose to work on discounting notes from Russian banks, Indonesian and Brazilian banks, and counterfeit Italian CDs. Letters of credit and CDs from Mexican credit unions and "brass plate" Caribbean banks were circulated. This development led to a number of arrests.

US law enforcement authorities launched an attack to discredit these schemes by claiming that there is no such thing as a "prime bank" so there can be no such thing as a "prime bank note." Although this may seem like hair-splitting, it is true that most HYIP promoters cannot describe the instruments they supposedly are trading. In 1994, the SEC launched a formal investigation of fraud in the offer and sale of prime bank notes. The fraudsters responded by changing their offers to be for "promissory bank notes." The same people who only months earlier had offered "prime bank notes" explained in hushed tones that – technically – the proper term to be used was "promissory bank notes." Offers were no longer made for the sale of prime bank notes, but rather for "top 25 Western European Banks (with normal exclusions)". Problem averted. This was a logical response to a law enforcement initiative. There would be many more such transformations and evolutions.

In 1993, rumors circulated that the International Chamber of Commerce was going to revamp the rules for the collateral business in a new document entitled "ICC 500." What would these new rules provide? For one, excessive broker commissions would no longer be tolerated. Also, no transactions less than \$50 Million USD would be permitted, and there would be no more "collateral first." I knew the ICC was in Paris, and was a real institution. Just as a matter of curiosity, I called the ICC and obtained a copy of the text of the new rules. They looked nothing like the faxes that had been circulating in the broker community. These were real rules regarding documentary credits, not roll programs. I obtained several other documents from the ICC and studied them. Again, nothing like the broker rumors.

In fact, there is a well-developed body of law on letters of credit and bank guarantees. There are numerous cases. There are well-known texts by John Dolan and Diane Wunnicke, and an excellent older book by a New York lawyer named Henry Harfield. There are monthly

newsletters on developments in letter of credit law edited by Professor James Byrne. All of this contradicted the assumptions and stories heard in the hotels of Zurich and Geneva, received on faded faxes, and whispered over drinks in London and Lugano.

The notion that an SLC or bank guarantee could easily be traded like a security was difficult to maintain once knowledge of them was gained. For one thing, transferring ownership of SLCs is not a simple thing, as it is for a security. There are a number of ways it can be done, but none as easy as transferring a security. Also, Euroclear and Cedel at this time would not accept SLCs on their system, which were increasingly becoming the gold standard for securities settlement ("book entry"). It should come as no surprise, therefore, that soon new terminology came along to replace the old. The new instrument was the "Medium Term Note." No longer were trades done on SLCs or PBGs, but now exclusively on MTNs. Of course, when pressed one could always claim that MTNs were a generic name for any kind of instrument between 1 and 10 years term, so this could include SLCs and PBGs, but that argument was seldom made. At the same time, program promoters suggested that no one use the term "roll program" any longer and instead use High Yield Investment Program ("HYIP"). The term "roll program" had become discredited. The HYIP would later face competition from the term Private Placement Opportunity ("PPO"). Always one step ahead of the law. It was a logical response.

By this time, the mythology of PBNs/roll programs/HYIP/PPO had become sufficiently engrained in the public mind that no explanation was normally needed. On every continent of the globe, businessmen scrambled to find access to the bank generated wealth. It was a commonly accepted assertion that 99% of HYIP offers were fraudulent, but such statements only spurred people on to find that other 1%.

Many intermediaries grew weary of chasing after an investor with \$10 Million. These investors were often difficult to work with, to say the least. Also, the deals never, ever closed. Accordingly, they developed several responses. As noted, many began to work with hard-to-place debt instruments from Russian banks, or Third World countries. Others searched out rented funds. If you can't locate a suitable investor, they reasoned, then why not rent the funds for a month and try the program out. A similar idea involved leasing Treasuries. Big securities firms lease Treasuries to their clients, so perhaps it could be done for entry into HYIP programs. This was a notorious failure. First, the Treasuries were simply not available to the type of individuals who wanted to lease them, and secondly the forms used by the promoters

were shown to be patently wrong. The whole affair was a disaster, and indeed some of the firms engaged in this effort in the United States faced prosecution.

One very creative response to the need for raising capital was the historical bond fraud. For several years in the mid 90s historical bonds were taken quite seriously by many people. There were several forms. Some of the first to surface were pre-World War II German gold bonds. Sometimes referred to as "Dawes and Younge" bonds, they were researched extensively by some. Such bonds really did exist under the Weimar Republic, but the copies being circulated by brokers would not be honored by the German government. A truly outlandish fraud involved bonds issued by bankrupt US railroads from the 19th Century. These attracted a great deal of attention for about a year or so, but when the most prominent promoter of such bonds, James Rice (alias: Sloan Dupont) was arrested on fraud charges and the story was on page one of the Wall Street Journal, interest understandably waned. A similar story was the so-called Japanese Series 57 Certificate of Redemption Balance. These were counterfeit bonds that circulated in the mid-90s in staggering denominations and amounts. The story was told that if the truth came out about how much the government of Japan owed on these bonds it would shock the banking system and bring down the government. So, the government unjustly denied their existence and nobody thought to bring legal action. The story did not withstand scrutiny. Ultimately, a number of arrests were made and word got around that these were dangerous instruments to be associated with. Several promoters of the Series 57 certificates plead guilty in Florida, as well as in North Carolina. A similar effort involved old Argentine pesos that are no longer honored. Millions of such worthless currency still circulates in certain circles, together with stories about why they are being offered.

Another significant response, however, was the development of the program for "small" investors – those with less than \$10 Million. By pooling a large number of small investors, promoters claimed, sufficient funds could be generated to participate in programs that once were available only to the rich. By the late 90s a number of small investor funds were promising big profits to investors with only modest amounts of money. Their names have become all too familiar – Omega, Tri-West, TAC, IFR, Le Club Prive, Elfindepan. Unfortunately, many individuals and families lost their entire savings to such a pitch, which was often coupled with either populist anti-government rhetoric or pronounced in the grip of religious fervor. The programs didn't exist, and the promoters generally skipped with the money or lost it to

other promoters.

Regrettably, this is the true history of bank debenture trading, prime bank instruments, HYIP, and the collateral business. It has nothing to do with Bretton Woods, the Federal Reserve, or secret markets available only to the chosen few, and everything to do with old-fashioned greed and dishonesty. It began as a fraud, it developed as a fraud, and it continues as a fraud. The story changed, the justifications evolved over time, but the end result has always been that investors lost money and no trading took place.